

Internal Revenue Service

memorandum

TL-N-1797-88

CC:TL:TS/TSANDERSON

date: MAR 10 1988

to: District Counsel, Chicago MW:CHI  
ATTN: Marjory Gerdes

from: Director, Tax Litigation Division CC:TL

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subject: Market Maker Partnerships/Stock Option Straddles  
[REDACTED]

This memorandum responds to your request for technical advice on the issue below.

Issue

Whether a project should be created for "market maker partnership" cases and, if so, whether the [REDACTED] case should be the lead case in the project.

Conclusion

We have no objection to the creation of a "market maker partnership" project once the scope of the project is determined. It is too early to tell, however, whether the [REDACTED] case should be the lead or test case for the project.

Facts

The petitioner, [REDACTED] was a partner in [REDACTED] partnership, which, according to the partnership, was formed [REDACTED]. On [REDACTED] the partnership was approved to engage in market making activities on the Chicago Board of Options Exchange (CBOE). The first trade was entered into on or before [REDACTED]. Registration as a broker or dealer under section 15(b) of the Securities Exchange Act was applied for on [REDACTED] and registration was granted by the SEC on [REDACTED].

The number of general partners is [REDACTED] according to the partnership and [REDACTED] according to the revenue agent report. The partner/employee whose status is in question is the person who conducted all the trading for the partnership on the floor of the CBOE.

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The CBOE membership of the partnership was withdrawn on [REDACTED]. The final partnership return filed was for [REDACTED] is the date given on the [REDACTED] partnership return for the year end of this calendar year partnership. No information, other than the [REDACTED] partnership tax return and the [REDACTED] individual return of the [REDACTED] is in the administrative file on the tax treatment accorded the dissolution/termination/liquidation of the partnership.

As we understand the facts, the Service disallowed the petitioners' distributive share of [REDACTED]'s stock option straddle losses for [REDACTED] on the primary ground that they were not entered into primarily for profit. Additionally, the petitioners' distributive share of ordinary losses from [REDACTED]'s stock option transactions that were not straddles were recharacterized as short-term capital losses on the ground that the partnership was not a dealer.

We understand that the petitioners' case is the only docketed one and that all the other partners have consented to extensions awaiting the outcome of this case. The partnership is not covered by the TEFRA unified audit provisions.

By memorandum dated December 10, 1987, you requested that we determine whether this case should be the lead case in a "market maker partnership" project. The facts above were derived from that memorandum and subsequent telephone conversations. At that time, the case was calendared for [REDACTED]. With the assistance of our office, a motion for continuance was prepared and filed. We were informed that the motion was granted, and the case will not get to trial probably until [REDACTED].

#### Discussion

The instant case has been referred to as a "market maker partnership" case. However, the legal issues in this case which are in common with the issues in other "market maker partnership" cases are more narrowly defined as concerning the deductibility of stock option straddle losses, and the character of stock option losses, incurred by a partnership that was allegedly a "market maker" in stock.

We have no objection to the creation of a project covering these legal issues. We suggest, however, that your office determine the scope of the project. For example, should the project be limited to "market maker partnership" cases in the Chicago district, and should it include individual "market maker" cases as well? We suggest that you contact Jerry Sevard in Chicago Appeals (866-0337) to determine how many cases are in Chicago Appeals with the same or similar issues. From this you can estimate the resources you will need to handle the project.

Once you have determined the scope of the project and the approximate number of investors that will be included, please forward a memorandum to the Tax Shelter Branch consistent with CCDM (35)3(12)7 so that we can formally establish the project.

As to whether the [REDACTED] case can be the lead or test case in a "market maker" project, it is impossible to tell at this point without knowing more about the other partnership or individual cases that may become part of the project. Any common factual threads need to be identified before designating any case as the lead case. For example, you should determine whether there are related entities involved in either the promotion of the partnerships or the trading activity.

If you have any questions about these or other related matters, please do not hesitate to contact Ted Sanderson on (FTS) 566-3233.

MARLENE GROSS

By: Kathleen E. Whatley  
KATHLEEN E. WHATLEY  
Chief, Tax Shelter Branch